RESEARCH BRIEF
CANADA INDUSTRIAL

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Industrial Sector Navigating Challenges as Manufacturing Activity Stalls

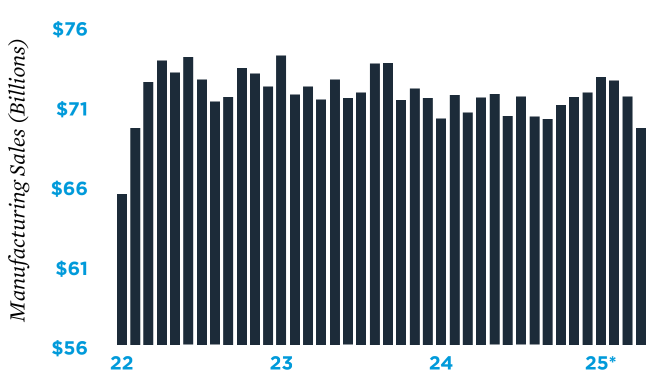
Manufacturing sales nosedived. The United States' "Liberation Day" tariff announcement in April dealt a significant blow to Canada's manufacturing sector. Although no additional tariffs were imposed on Canadian exports in April, the hit to global business sentiment sent shock waves through the country's manufacturing sector. Total sales fell by 2.8 per cent month over month, while new orders plunged 6.8 per cent – the sharpest monthly drop since July 2022. Sales of petroleum and coal products led the decline, tumbling 10.9 per cent to their lowest level since August 2021. Meanwhile, a partial shutdown at several assembly plants in Ontario caused sales of motor vehicles and parts to shrink by 8.3 per cent – the steepest monthly decrease since December 2023.

Worst days may now be behind us. While the April reading for manufacturing sales came in worse than the flash estimate, the sharp decline was not entirely unexpected. Even so, the 90-day tariff pause and continuing benefits from the USCMA may mark April as the low point for manufacturing activity this year – assuming tensions do not flare up again. May and June could remain sluggish; businesses likely stayed cautious, and some manufacturers were still in the process of making their products compliant with USMCA requirements. If trade tensions stay contained, businesses are expected to regain some lost ground in the second half of the year. That said, product-specific tariffs will continue to pose a significant headwind for the manufacturing sector throughout 2025.

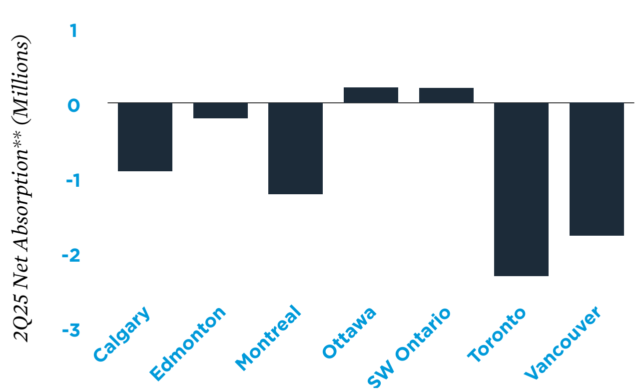
Bank of Canada likely to wait and see. The sharp drop in manufacturing shipments is unlikely to surprise the BoC, which had already projected a considerably weaker second quarter. Given the cautious tone at its June meeting, and with policy rates already lowered substantially, the monetary authority may opt to stay on hold as long as recession risks abate and inflation remains contained. This may lead to a higher year-end policy rate than previously expected. Nevertheless, financial markets continue to anticipate that weaker growth will carry more weight in the central bank's policy deliberations, leading to additional rate cuts before the end of the year.

Space demand appears to be holding up in Southwestern Ontario. Weak April manufacturing sales confirm there has been a pullback in second-quarter industrial space demand. The latest data shows that 6.0 million square feet of space has been shed so far this quarter across Canada, pushing the national vacancy rate up to 3.8 per cent. Yet surprisingly, net absorption has stayed positive in Southwestern Ontario, defying expectations that the region – one of Canada's key manufacturing and transportation hubs – would be among the hardest hit by trade tensions. Amid economic uncertainty, some firms may have relocated from the Greater Toronto Area in search of lower rents. Strategic stockpiling within the metro, which offers easier cross-border access, may have also provided a buffer. Additionally, the region's high concentration of food and agri-processing operations, which tend to be recession-resistant, has likely helped sustain demand, particularly for controlled-environment warehousing.

Manufacturing Sales Reached 3-Year Low



Space Absorption Holding Up in SW Ontario



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* Through April; ** Preliminary estimate
Sources: IPA Research Services; Altus Data Solutions; Statistics Canada